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No. 89-1110

In the Supreme Court of the United States

OCTOBER TERM, 1989

EDUCATIONAL DEVELOPMENT NETWORK CORPORATION AND GERALD KRESS, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the issuance of administrative subpoenas by the Department of Defense Inspector General, pursuant to an agreement whereby the subpoenaed documents would be shared by the Department of Defense and the United States Attorney's Office in their joint investigation of petitioners, violated the Inspector General Act of 1978, 5 U.S.C. App.*

2. Whether the presentation to a grand jury of materials subpoenaed by the Department of Defense Inspector General's Office in the course of a joint Department of Defense/Department of Justice investigation of petitioners violated Federal Rule of Criminal Procedure 6(e), which limits the disclosure of "matters occurring before the grand jury."

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* The Inspector General Act of 1978 is codified at 5 U.S.C. App. at 1184-1198.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-15a) is reported at 884 F.2d 737. The memorandum opinion of the district court (Pet. App. 19a-22a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on September 7, 1989. A petition for rehearing was denied on October 17, 1989 (Pet. App. 23A-24A). The petition for a writ of certiorari was filed on January 16, 1990 (a Tuesday following a Monday holiday). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following the entry of a conditional plea of guilty in the United States District Court for the Eastern District of Pennsylvania, petitioners were convicted of mail fraud, in violation of 18 U.S.C. 1341; false claims, in violation of 18 U.S.C. 287; and false statements to a government agency, in violation of 18 U.S.C. 1001. In addition, petitioner Kress was convicted of paying gratuities to a public official, in violation of 18 U.S.C. 201. Petitioner Educational Development Network Corporation (EDN) was sentenced to a $100,000 fine. Petitioner Kress was sentenced to a term of imprisonment of a year and a day, to be followed by five years' probation. He was also ordered to pay $300,000 in restitution to the United States.

1. Petitioners challenge the validity of subpoenas issued by the Inspector General of the Department of Defense, and the presentation of evidence gathered by those subpoenas to the grand jury that indicted petitioners. The Inspector General Act of 1978 established offices of Inspector General in a number of departments and agencies. The Act was enacted in response to congressional concern that fraud, abuse, and waste in United States agencies and federally funded programs were "reaching epidemic proportions." S. Rep. No. 1071, 95th Cong., 2d Sess. 4 (1978). Congress attributed the problem in large part "to certain basic organizational deficiencies in the way executive establishments have approached their audit and investigative responsibilities." *Id.* at 5. To combat the problem, Congress centralized audit and investigative functions within each department under one high-level official, an Inspector General, and gave him broad powers to search out fraud and waste in agency operations and programs. 5 U.S.C.

App. 2-4. The Act gives each Inspector General both civil and criminal investigative authority.[1]

The Act provides that it shall be the duty and responsibility of each Inspector General "to conduct, supervise, or coordinate relationships between [his agency] and other Federal agencies * * * with respect to (A) all matters relating to the promotion of economy and efficiency in the administration of, or the prevention and detection of fraud and abuse in, programs and operations administered or financed by such [agency], or (B) the identification and prosecution of participants in such fraud or abuse." 5 U.S.C. App. 4(a)(4). The Act directs the Inspector General to report to the Attorney General whenever there are grounds to suspect violations of federal criminal law (5 U.S.C. App. 4(d)), and it charges the Department of Defense Inspector General with the responsibility for guiding all Defense Department activities relating to criminal investigations (5 U.S.C. App. 8(c)(5)). To enable the Inspector General to discharge these duties, the Act grants him broad subpoena power. 5 U.S.C. App. 6(a)(4).[2]

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[1] The original Inspector General Act did not include an Inspector General for the Department of Defense because, unlike other federal agencies, the Department of Defense had long maintained a large audit and investigative staff assigned to various units within the Department. Subsequently, however, Congress determined that centralization of audit and investigative efforts within the Department of Defense was also necessary. Accordingly, in the Department of Defense Authorization Act, 1983, Congress amended the Inspector General Act of 1978 to create an Inspector General within the Defense Department. Pub. L. No. 97-252, § 1117(a)(1), 96 Stat. 750; *United States* v. *Aero Mayflower Transit Co.*, 831 F.2d 1142, 1145 n.1 (D.C. Cir. 1987); *United States* v. *Westinghouse Electric Corp.*, 788 F.2d 164, 165 (3d Cir. 1986).

[2] 5 U.S.C. App. 6(a)(4) provides:

In addition to the authority otherwise provided by this Act, each

2. Petitioner EDN and its owner, petitioner Gerald Kress, entered into a non-competitive contract with the United States Department of Defense to provide an educational and employment training program to the Army National Guard Bureau. During the summer of 1986, a former EDN employee and several government officials alerted the United States Attorney's Office to possible wrongdoing in connection with the cost and pricing information that EDN was providing to the Department of Defense. Before any subpoenas were issued, the United States Attorney's Office and the Inspector General of the Department of Defense agreed to conduct a joint investigation and to use Inspector General subpoenas, rather than grand jury subpoenas, so that the agencies could avoid the secrecy requirements of Rule 6(e) and share the evidence obtained. Pet. App. 3a-4a & n.5.

On October 2, 1986, the United States Attorney's Office in Philadelphia opened a grand jury file on EDN, Kress, and Lieutenant Colonel Robert Allen Baxter, the official who oversaw and approved the work called for by the EDN contract. That Office filed an *ex parte* Rule 6(e) notice of disclosure with the United States District Court for the Eastern District of Pennsylvania, which listed the Assistant United States Attorney in charge of the file. However, no information was presented to the grand jury until January 13, 1988. Pet. App. 3a-4a.

Inspector General, in carrying out the provisions of this Act, is authorized—

* * * * *

(4) to require by subpena the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary in the performance of the functions assigned by this Act, which subpena, in the case of contumacy or refusal to obey, shall be enforceable by order of any appropriate United States district court: *Provided*, That procedures other than subpenas shall be used by the Inspector General to obtain documents and information from Federal agencies.

On October 3, 1986, William Weinstein, a special agent of the DOD Inspector General, Criminal Investigative Service, served an Inspector General subpoena on EDN. On October 30, 1986, before the return date of the subpoena, the Department of Defense obtained a warrant to search the EDN offices for many of the same documents that were covered by the subpoena. The Department of Defense took possession of the documents seized during the search, as well as of the additional documents subsequently turned over by EDN pursuant to the subpoena. The documents were made available to the civil and criminal divisions of the United States Attorney's Office, the Department of Defense Inspector General's Office, and the Army Criminal Investigation Division, which was investigating Baxter. Pet. App. 4a.

On January 6, 1988, the Department of Defense was told to complete all communications with the civil division of the United States Attorney's Office by January 13, 1988, when the grand jury's criminal investigation was to begin. Pet. App. 5a. The information collected during the joint investigation, together with additional information obtained pursuant to grand jury subpoena, see Pet. App. 5a n.5, was presented to the grand jury.

The grand jury returned an indictment on July 13, 1988, charging that petitioners submitted inflated estimates of EDN's costs to the Department of Defense. The indictment also charged that petitioner Kress paid, and DOD contract officer Baxter received, illegal gratuities in return for approving the contracts. See Pet. App. 5a.

3. On October 14, 1988, petitioners filed a motion to compel discovery in aid of a suppression motion, alleging that the United States Attorney's Office had acted in "bad faith" when it used Inspector General subpoenas and a search warrant to gather evidence during the joint investigation. The motion sought an order compelling additional

discovery, as well as a hearing to determine whether the United States Attorney's Office had violated petitioners' Fifth Amendment rights to due process and to an indictment only by action of a grand jury. Petitioners based their request on *United States* v. *LaSalle National Bank*, 437 U.S. 298 (1978), which imposed certain restrictions on the Internal Revenue Service's use of its summons authority when pursuing an investigation that may result in criminal charges. Pet. App. 5a-6a. After the district court denied the motions, petitioners filed a motion to suppress evidence and to dismiss the indictment, once again based on the *LaSalle* argument. Pet. App. 6a.

Following a hearing, the district court held that petitioners had failed to make a prima facie showing that the United States Attorney's Office had engaged in grand jury abuse. Pet. App. 22a. Specifically, the court found (*ibid.*):

> [N]o evidence was presented to the grand jury until January 1988, a date subsequent to the period during which defendants suggest that grand jury material may have been disclosed to the Department of Defense. Since the grand jury had not heard any evidence, there was nothing to disclose prior to January 1988 that would violate Rule 6(e).

The district court also held that *LaSalle* was an interpretation of statutes governing IRS investigative authority, under which "Internal Revenue Service civil investigative authority ceases for all practical purposes upon referral of a case for criminal prosecution." Pet. App. 20a. Because the DOD Inspector General "is not barred from proceeding with an investigation in connection and in cooperation with a criminal investigation being conducted by the Department of Justice," *ibid.*, the district court held that *LaSalle* did not cast doubt on the issuance or use of Inspector General subpoenas in this case.

On November 29, 1988, the date trial was to start, petitioners entered a conditional plea of guilty to the charges contained in the indictment.

4. The court of appeals affirmed the conviction, holding that the district court had properly denied petitioners' motion to suppress the evidence that was obtained by the use of Inspector General subpoenas and a search warrant. Pet. App. 7a-15a. The court rejected petitioners' contention that Rule 6(e) bars the United States Attorney's Office (USAO) "from participating in other agencies' investigations before it actually begins presentation of evidence to the grand jury, and [petitioners] refer us to no statutory or case law to the contrary." Pet. App. 7a-8a. The court observed that "[w]hat occurred here is the USAO's disclosure of information obtained by DOD to the grand jury, not the USAO's disclosure of information obtained by the grand jury to the DOD." Pet. App. 9a. Because the United States Attorney's Office ceased communicating with the DOD and the Army about the investigation after it began presenting evidence to the grand jury, the court held that there was no Rule 6(e) violation. Pet. App. 9a.

The court of appeals also noted that petitioners had failed to direct the court's attention "to any statutory, regulatory, or case law that prevents the USAO" from engaging in a cooperative investigation that makes use of the Inspector General's civil investigative powers. Pet. App. 9a. The court read *LaSalle* to hold that the IRS could not issue summonses for the sole purpose of assisting in a criminal investigation because the governing statute did not authorize the IRS to issues summonses for this purpose. Pet. App. 10a. The subpoenas issued here, in contrast, were well within the authority of the Inspector General; as the court observed, "[t]here is nothing in this record to show that the agency investigation itself was improper or used as a subterfuge by the USAO." Pet. App. 14a n.11. Thus, the court was able

to find "no law or principle that would prevent [the USAO] from presenting to the grand jury facts properly uncovered in the course of lawful investigations by another agency." Pet. App. 14a.

ARGUMENT

1. Petitioners contend that "Congress specifically intended that * * * Inspectors General would be prohibited from lending their subpoena power" to the Department of Justice. Pet. 9. That contention rests on erroneous factual and legal premises.

As a factual matter, the court of appeals repeatedly emphasized that the Inspector General issued the contested subpoenas in a good faith effort to advance his own investigation.[3] The record thus reflects that the Inspector General did not "lend" his subpoena power to the Department of Justice, but rather that the Inspector General issued subpoenas in an effort to gather information that could potentially be used for civil, contractual, and administrative purposes. This case thus concerns the legitimacy of a cooperative Inspector General/Department of Justice investigation, not the "lending" of subpoena power by one agency to another.

Because the Inspector General was conducting a legitimate DOD investigation, petitioners' claim reduces to the assertion that such an investigation must proceed entirely in-

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[3] For example, the court of appeals noted that "neither the DOD nor the Army was acting beyond its statutory requirements in conducting its investigation" (Pet. App. 12a), that petitioners "fail[ed] to show that the DOD or Army acted in bad faith or otherwise improperly in carrying out its investigations" (Pet. App. 14a), that "the IG subpoenas were properly issued in the course of a DOD investigation" (*ibid.*), and that "[t]here is nothing in this record to show that the agency investigation itself was improper or used as a subterfuge by the USAO" (Pet. App. 14a n.11).

dependently of any criminal inquiry conducted by the Department of Justice. The only other court that has considered the issue presented by petitioners has squarely rejected the notion that information acquired by the Department of Defense Inspector General pursuant to his subpoena power may not be shared with the Department of Justice. See *United States* v. *Aero Mayflower Transit Co.*, 831 F.2d 1142, 1146 (D.C. Cir. 1987).

Far from supporting petitioners' claim, the text and legislative history of the Inspector General Act establish that such cooperation is required, not forbidden. As outlined above, the statute expressly directs the Department of Defense Inspector General to pursue criminal investigations. The broad statutory grant of authority provides that it is the Inspector General's duty and responsibility "to conduct, supervise, or coordinate relationships between [his agency] and other Federal agencies * * * with respect to * * * the identification and prosecution of participants in * * * fraud or abuse." 5 U.S.C. App. 4(a)(4). He is also directed to report to the Attorney General suspected violations of federal criminal law, 5 U.S.C. App. 4(d), and to guide all DOD activities relating to criminal investigations, 5 U.S.C. App. 8(c)(5).

The legislative history makes it clear that one of the key purposes of the Act was to strengthen coordination between federal agencies and the Department of Justice in investigating criminal fraud cases. The Senate Report accompanying the Inspector General Act explained that the Department of Defense "has not worked very effectively with the Department of Justice to investigate and prosecute criminal fraud in its programs," and noted that the Department of Defense "has extraordinary investigative resources at its disposal." S. Rep. No. 1071, 95th Cong., *supra*, at 21.[4] The Report observed that "coordination between

[4] As we have pointed out, see note 1, *supra*, the Inspector General Act of 1978, in connection with which the cited report was issued, did

the investigative agencies" of each of the armed services and the FBI had been "inadequate." *Id.* at 22. By providing "coordination and leadership," the Inspector General was expected to "strengthen[ ] cooperation between the agency and the Department of Justice in investigating and prosecuting fraud cases." *Id.* at 6-7.

Petitioners cite portions of the legislative history of the 1978 Act that express concern that the Inspector General's functions not supplant the prosecutorial functions of the Department of Justice, as well as provisions of the enacted legislation that require the Inspector General to report suspected criminal violations to the Department of Justice.[5]

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not create an Inspector General for the Department of Defense. Nonetheless, it is reasonable to suppose that, when Congress brought the Department of Defense within the scope of the Inspector General Act in 1982, it did so for the reasons for which that step was advocated in the 1978 Report. There is nothing in the meager legislative history of the 1982 amendment to suggest otherwise. See H.R. Rep. No. 749, 97th Cong., 2d Sess. 175-178 (1982).

[5] Petitioners refer (Pet. 13) to the following language in the Senate Report on the 1978 Act as support for their claim that the Inspector General exceeded his statutory authority in issuing the subpoenas in question:

> The committee intends, of course, that the Inspector and Auditor General will use this subpena power in the performance of his statutory functions. The use of subpena power to obtain information for another agency component which does not have such power would clearly be improper.

S. Rep. No. 1071, *supra*, at 34.

The quoted passage refers to improper use by an Inspector General of his subpoena power on behalf of another component *of his own agency* that is not involved in audits or investigations and has no subpoena power of its own. The Department of Justice is in no sense an "agency component" of the Department of Defense, and here the Inspector General in any event issued the subpoenas to advance his own investigation. The passage therefore casts no doubt on the validity of the cooperative investigation undertaken in this case. See also *United States v. Westinghouse Electric Corp.*, 788 F.2d 164, 167 (3d Cir. 1986) (holding that, given the distribution of auditing and investigative

Pet. 9-13. However, the fact that the responsibility for actual criminal prosecution continues to rest with the Department of Justice does not mean that the Inspector General may not assist in that prosecution by providing the Justice Department with information acquired in the course of his own investigation. Indeed, the very testimony quoted by petitioners that the Inspector General will "complement," rather than "substitute for," the FBI implies approval of precisely the kind of cooperative arrangement employed in this case. See Pet. 12.

2. a. *United States* v. *LaSalle National Bank*, 437 U.S. 298 (1978), does not support petitioners' position that the use of civil investigative powers is improper when there is an ongoing criminal investigation. In *LaSalle*, this Court reversed a decision of the court of appeals that had refused to enforce an IRS summons issued pursuant to 26 U.S.C. 7602 because the motivation of the individual agent conducting the investigation was to gather evidence for a prospective recommendation for criminal prosecution. This Court held that the prophylactic rule of *Donaldson* v. *United States*, 400 U.S. 517 (1971), precluding use of an IRS summons following an IRS recommendation for criminal enforcement, should apply only after the IRS has determined institutionally to recommend criminal prosecution.

At the time *LaSalle* and *Donaldson* were decided, the Internal Revenue Code provided that the IRS's summons authority was to be used solely to aid in the determination and collection of taxes, and not to pursue a criminal investigation.[6] After referring a case to the Justice Depart-

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functions in the Department of Defense, the Inspector General of the Department may share subpoenaed material with other DOD "agency components" that share such functions).

[6] Following *LaSalle*, Congress broadened the IRS's summons power to allow inquiry into any revenue-related offense. See 26 U.S.C. 7602(b) and (c).

ment for prosecution, the IRS held all civil action in abeyance until the criminal proceeding was completed. Thus, as a practical matter, the statutory purposes for which summonses could ordinarily be issued under Section 7602 could not support the issuance of summonses while a criminal proceeding was pending. For that reason, the Court adopted a "prophylactic" rule forbidding the IRS to use its summons authority under Section 7206 once a case had been referred to the Department of Justice for criminal prosecution. 437 U.S. at 312.

The limited powers of the IRS in *LaSalle*, however, stand in sharp contrast to the investigative powers of the Department of Defense Inspector General. As outlined above, Congress explicitly directed the Inspector General to engage in criminal investigations. Because the Department of Defense Inspector General was simply fulfilling his own statutory responsibilities, he did not abuse his subpoena power. See *United States* v. *LaSalle National Bank*, 437 U.S. at 311-316.

The decision below was in full accord with the numerous decisions in which courts have rejected attempts to superimpose the analysis of the tax summons cases upon entirely different statutory frameworks. See, *e.g.*, *United States* v. *Gel Spice Co.*, 773 F.2d 427, 432-433 (2d Cir. 1985), cert. denied, 474 U.S. 1060 (1986); *Donovan* v. *Spadea*, 757 F.2d 74, 77-78 (3d Cir. 1985); *United States* v. *Merit Petroleum, Inc.*, 731 F.2d 901, 905 (Temp. Emer. Ct. App. 1984); *In re EEOC*, 709 F.2d 392, 398-399 & n.2 (5th Cir. 1983); *SEC* v. *Dresser Industries, Inc.*, 628 F.2d 1368, 1377-1384 (D.C. Cir.) (en banc), cert. denied, 449 U.S. 993 (1980). Petitioners cite no authority to the contrary.

b. Petitioners also argue (Pet. 7-9, 13) that the decision below is at odds with the Court's observation in *LaSalle* that an IRS summons should not be used "to broaden the Justice Department's right of criminal litigation discovery or to infringe on the role of the grand jury as a principal tool of

criminal accusation." 437 U.S. at 312. This case, however, raises none of the concerns identified in the quoted passage from *LaSalle*.

Because the Inspector General issued the subpoenas in this case long before the indictment—indeed long before any evidence had been presented to the grand jury—this case does not involve any improper broadening of the government's right to post-indictment "discovery," see Fed. R. Crim. P. 16(b).[7] Insofar as the *LaSalle* Court was concerned with a broadening of the government's pre-indictment investigative powers, the court of appeals expressly noted that the United States Attorney's Office did not use the Inspector General subpoenas as a "subterfuge" to obtain information that a grand jury would not or could not have subpoenaed. Pet. App. 14a n.11. The grand jury's own investigative powers are at least as broad as those of the Department of Defense Inspector General. Cf. *SEC* v. *Dresser Industries*, 628 F.2d at 1381. As the court explained in *United States* v. *Aero Mayflower Transit Co.*, 831 F.2d at 1146, in rejecting an argument identical to the one raised here:

> [There is no suggestion] of any restriction on the Justice Department's power to obtain through the grand jury process all the information sought by the subpoenas here at issue. The Inspector General subpoenas clearly did not operate to circumvent statutory or other limitations on the Justice Department's investigative powers. The use of Inspector General subpoenas, instead of grand jury subpoenas, did, however, further an important Defense Department interest. Infor-

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[7] The rules of criminal discovery (and their attendant restrictions) do not come into play until charges are returned by indictment or information. *Post* v. *United States*, 161 U.S. 583, 587 (1896); *SEC* v. *Dresser Industries*, 628 F.2d at 1381.

> mation obtained through a grand jury would not be readily available to the Defense Department in pursuing civil remedies against those who may have defrauded it. See Fed. R. Crim. P. 6(e). The procedure followed by the two Departments of government was, therefore, reasonably calculated to serve the legitimate interests of both.

Nor does this case involve any interference with the "role of the grand jury as a principal tool of criminal accusation." *LaSalle*, 437 U.S. at 312. Numerous cases have established that the "grand jury's sources of information are widely drawn." *United States* v. *Calandra*, 414 U.S. 338, 344 (1974). The grand jury may consider evidence from all sources, including any evidence transmitted to the Department of Justice by the Department of Defense. Cf. *Branzburg* v. *Hayes*, 408 U.S. 665, 701 (1972). The transmittal of relevant evidence to the Department of Justice for presentation to the grand jury plainly assists, rather than undermines, the grand jury's function.[8]

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[8] Petitioners' contention that there was a violation of Fed. R. Crim. P. 6(e) is mistaken, as both the court of appeals and the district court held. See Pet. App. 7a-9a, 22a. Rule 6(e) does not bar disclosure of information to the grand jury, as occurred in this case. Rather, it limits the disclosure to unauthorized persons of "matters occurring before the grand jury."

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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